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Great Plains Region

Audit Report

Farm Service Agency Livestock Feed and Compensation Programs

Report No. 03099-52-KC
September 2005



UNITED STATES DEPARTMENT OF AGRICULTURE

OFFICE OF INSPECTOR GENERAL



Washington D.C. 20250

DATE: September 30, 2005

REPLY TO
ATTN OF: 03099-52-KC

TO: Michael W. Yost
Acting Administrator
Farm Service Agency

ATTN: T. Mike McCann
Director
Operations Review and Analysis Staff

FROM: Robert W. Young /s/
Assistant Inspector General
for Audit

SUBJECT: Farm Service Agency - Livestock Feed and Compensation Programs

This report presents the results of our audit of the Farm Service Agency Livestock Feed and Compensation Programs. Your responses to the draft report, dated September 16 and 30, 2005, are included in its entirety as exhibit C with excerpts and the Office of Inspector General's position incorporated into the Findings and Recommendations sections of the report where applicable.

The September 30, 2005, response advised that with the urgent needs related to Hurricanes Katrina and Rita, the Deputy Administrator for Commodity Operations has been required to shift many resources to handle the response to these devastating events and was unable to provide a response to Recommendations 1 through 5, 11, and 12 at this time. Therefore, we are unable to accept management decisions for these seven recommendations. For the other five recommendations addressed in your response, we accept your management decisions for Recommendations 6 and 7. Please follow your agency's internal procedures in forwarding final action to the Office of the Chief Financial Officer (OCFO).

We are providing a separate memorandum to the agency and OCFO that provides specific information on the actions to be completed to achieve final action. Final action on the management decisions for these two recommendations should be completed within 1 year of the date of this report to preclude being listed in the Department's Performance and Accountability Report.

In accordance with Departmental Regulation 1720-1, please furnish a reply within 60 days describing the corrective actions taken, or planned, and the timeframes for implementation for Recommendations 1 through 5, 11, and 12. Additionally, to achieve management decisions for Recommendations 8, 9, and 10, please provide the timeframes for developing and accomplishing the corrective actions mentioned in the response. Please note that the regulation requires a management decision to be reached on all findings and recommendations within a maximum of 6 months from report issuance.

We appreciate the cooperation and courtesies extended to us by your staff during the audit.

Executive Summary

Farm Service Agency, Livestock Feed and Compensation Programs (Audit Report No. 03099-52-KC)

Results in Brief

This report presents the results of our review of U.S. Department of Agriculture (USDA) Livestock Feed and Compensation Programs, including the 2002 Cattle Feed Program (CFP), the 2003 Nonfat Dry Milk Livestock Feed Assistance (NDMA), and the 2002 Livestock Compensation Program (LCP). Our overall objective was to evaluate the adequacy of established internal controls to ensure that the forms of assistance afforded livestock producers were only made available to eligible participants for intended purposes of providing supplemental feed to eligible livestock. Our objective included ensuring that participants received correct amounts of feed assistance and that the authorized forms of assistance were administered in compliance with applicable laws, regulations, and procedures. We also evaluated a request from a U.S. Congressman with regard to the propriety of payments made to livestock producers under LCP. Specifically, the Congressman's request expressed concerns with LCP payments made under expanded eligibility criteria to livestock owners who may not have suffered a loss or damage to their livestock operations.

Our review identified material internal control weaknesses in the distribution of nonfat dry milk (NDM) for livestock feed through the 2002 CFP. We found that information related to numbers of certified eligible livestock, recommended rates of incorporation of NDM into animal feed rations, and feed dealer capabilities to manufacture or mix livestock feed was not considered in evaluating the reasonableness of feed dealer requests for NDM. The absence of effective controls over the ordering and distribution of NDM resulted in excess quantities of NDM being delivered to specific sites. Inability on the part of feed dealers to timely incorporate NDM into livestock feed products and provide such products to eligible livestock producers led to large quantities of NDM being stored outside where it was susceptible to adverse weather conditions and spoilage. In addition, NDM was shipped to locations outside those States eligible for livestock feed assistance (including foreign countries), and possibly incorporated into products that may have ended up in the human food chain. Furthermore, USDA recourse against program violators was restricted due to the nominal value it placed on NDM, and specific penalties and sanctions were not specified in program contracts and agreements. Within the four eligible States, approximately 50,000 livestock producers received nearly \$137 million in feed credits for about

6 million head of livestock. A total of 242 million pounds of NDM was shipped to over 1,800 feed dealers.

Under the 2003 NDMA, Farm Service Agency (FSA) delegated authority for administering certain aspects of the program to the participating State and Tribal Governments. The 2003 assistance was administered by 12 State Departments of Agriculture and seven Native American Tribal Governments and approximately 330 million pounds of NDM was distributed as of November 2004. We noted that the 2003 NDMA was not consistently or effectively administered by the States and Tribal Governments. We concluded that the bartering provision instituted by the State and Tribal Governments contributed to the development of secondary markets through which distributed NDM was bought and sold for profit. While FSA was responsible for ensuring that third parties (parties other than eligible producers and participating feed dealers) complied with the NDM distribution and use restrictions, the agency was hampered in its attempts to take action against such parties, as the Department did not hold direct agreements with such third party entities. We further noted that feed dealer agreements developed by State and Tribal Governments were not standardized with respect to specifying the restricted use provisions associated with NDM.

We found that allegations of potential program abuse related to the 2002 CFP and the 2003 NDMA were not subject to timely follow up by agency officials or referred to the Office of Inspector General (OIG) as required by procedure. Two such referrals involved shipments of NDM to locations outside the designated eligible areas (including overseas shipments to foreign countries) and possibly for ineligible uses including incorporation in human food products.

To respond to an inquiry from a U.S. Congressman, we evaluated the appropriateness of payments issued under the expanded eligibility criteria for the 2002 LCP. Specifically, the Congressman was concerned that livestock producers may have received program benefits for disasters that did not result in actual losses to their livestock operations. To address the Congressman's concerns, we examined the legislative and regulatory language associated with the program; interviewed FSA and Office of the General Counsel officials regarding the program's eligibility criteria; and analyzed automated program data to ascertain the amounts of payments issued to producers under the established county eligibility criteria.

Our review of the legislation and regulations indicated that the expanded eligibility criteria for the Livestock Compensation Program II

(LCP-II) allowed for the issuance of payments to livestock producers in non-drought related disasters to receive the same livestock compensation payment rate that was initially established through an economic analysis of drought impacted disaster areas. The initial LCP restricted assistance to producers with livestock operations physically located in drought-stricken counties and applicants were not required to show proof of losses or damages in order to receive payments. However, the Agricultural Assistance Act of 2003 subsequently expanded the disaster eligibility criteria under LCP-II to include other kinds of disasters and emergencies and extended the time period for eligibility. Therefore, for both the initial LCP program and LCP-II, the producer's eligibility was based on location rather than actual losses.

Department officials interpreted the Agricultural Assistance Act of 2003 as expanding the number of eligible producers. As a result, producers whose livestock operations were headquartered in States and counties with qualifying disaster declarations, but were not affected by the qualifying events under the initial program, received LCP assistance at a rate equal to those producers whose livestock operations were affected by long-term conditions such as drought.

We noted that LCP-II payments of about \$159 million were issued to livestock producers in non drought-declared counties. Because producers in these counties were not required to provide proof of loss, we did not contact any of them to determine if they had, in fact, received LCP assistance without sustaining a commensurate loss to their livestock operations. Furthermore, we had no recourse to collect any unwarranted assistance payments because neither the legislation nor the regulations required proof of loss.

In addition to reviewing LCP based on the Congressman's concerns, we also reviewed FSA's management controls over the LCP and LCP-II programs. Overall, we determined that FSA effectively administered the LCP programs but we did note minor weaknesses related to LCP approval authority and random spot checks. We noted that program applications submitted by USDA employees were not always subject to appropriate approval authority and that random spot checks were not always properly selected or completed at the county office level.

On July 16, 2004, the Commodity Credit Corporation (CCC) announced the 2004 Non-fat Dry Milk Livestock Feed Assistance Initiative to provide assistance to livestock producers in States that needed help in maintaining foundation livestock herds as the result of extreme drought conditions. Eligible States and counties were to be determined by FSA using the U.S. National Drought Monitor. State

and Tribal allocations of NDM were limited based on available inventories of CCC-owned NDM and 75 percent of the size of foundation livestock herds. Eligible feed dealers entered into restricted use sales agreements with CCC. The agreements specified that NDM would be denatured and sold to feed dealers for \$275.00 per truckload (41,500 pounds). The agreements also specified that NDM must be used to feed foundation livestock and prohibited exportation of NDM.

We believe that FSA implemented significant actions to alleviate potential abuses in the livestock feed programs, including many of the issues identified in this audit report. FSA's implementation of the 2004 Nonfat Dry Milk Livestock Feed Assistance Initiative incorporated significant improvements that hopefully led to the prevention of NDM abuses. We believe the denaturing of NDM and the additional management controls instituted by FSA should have improved the integrity of the provided assistance. However, we believe FSA needs to further evaluate whether future distributions of NDM can be effectively monitored and controlled to provide reasonable assurance that USDA commodities are used in the manner intended. Absent such reasonable assurance, we suggest that FSA consider other alternatives for providing livestock feed assistance to affected producers.

Recommendations In Brief

Current inventory quantities of NDM are reduced to a level that provides for relatively little surplus commodity beyond the needs of domestic feeding programs. Thus, FSA officials do not foresee a continuation of NDM for livestock feed assistance in the near future. However, agency officials do acknowledge it is likely that at some point in time, USDA will again be involved in purchasing NDM. Because no one can predict when or if future inventory quantities of NDM will reach levels similar to those that existed in 2002 and 2003, we recommended that FSA perform an internal assessment of lessons learned from the 2002 CFP and the 2003 NDMA. The assessment should address areas of noted concern related to the distribution and end use of NDM and aid the agency in developing strategies to provide reasonable assurance that any future allocations of NDM are used for the intended purpose of providing a protein supplement for livestock feed. Developed strategies should encompass possible scenarios including a livestock feed program administered by FSA or a livestock feed assistance initiative administered by State and Tribal Governments. In addition, FSA needs to address a sufficient compliance review program that ensures the proper accountability and disposition of NDM. We also recommended that for future livestock assistance programs FSA establish supplemental eligibility criteria for

locations experiencing disasters, such as producer submitted proof of loss or performance of an economic analysis that ties the disaster payment rate to existing conditions within the eligible areas.

Agency Response

Due to urgent needs relating to Hurricanes Katrina and Rita, the Deputy Administrator for Commodity Operations was required to shift resources to handle the response to these devastating events and was unable to provide written comments at this time to the seven recommendations (Recommendations 1 through 5, 11, and 12) directed to it. The Deputy Administrator for Farm Programs generally concurred with the recommendations relating to LCP (Recommendations 6 through 10).

OIG Position

We concur with proposed actions in the agency response for the five recommendations relating to LCP. Based on the information provided, we accepted management decisions on Recommendations 6 and 7. For Recommendations 8, 9, and 10, FSA needs to provide the timeframes for completing the proposed actions before we can accept the management decisions. For the seven recommendations directed to the Deputy Administrator for Commodity Operations, it will need to provide its response to these recommendations, including the corrective actions taken or planned and the timeframes for implementing any corrective actions.

Abbreviations Used in This Report

CCC	Commodity Credit Corporation
CED	County Executive Director
CFP	Cattle Feed Program
CO	County Office
COC	County Committee
ERS	Economic Research Service
FSA	Farm Service Agency
KCCO	Kansas City Commodity Office
KCFO	Kansas City Finance Office
LCP	Livestock Compensation Program
LCP-II	Livestock Compensation Program Phase II
NDM	Nonfat Dry Milk
NDMA	Nonfat Dry Milk Livestock Feed Assistance
OCFO	Office of the Chief Financial Officer
OIG	Office of Inspector General
STO	State Office
USDA	U.S. Department of Agriculture
WLED	Warehouse Licensing and Examination Division

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Background and Objectives

Background

Based on extreme drought conditions affecting various parts of the United States, the U.S. Department of Agriculture (USDA) initiated a series of assistance efforts to help livestock producers with the costs of obtaining supplemental livestock feed. Three of these assistance efforts included the 2002 Cattle Feed Program (CFP), the 2003 Nonfat Dry Milk Livestock Feed Assistance (NDMA), and the 2002 Livestock Compensation Program (LCP).

2002 Cattle Feed Program

On August 12, 2002, the Secretary of Agriculture announced the 2002 CFP, which authorized \$150 million for feed assistance to help farmers and ranchers with foundation beef cattle herds in Colorado, Nebraska, South Dakota, and Wyoming. The Farm Service Agency (FSA) administered the 2002 CFP through the acceptance of producer program applications, establishment of producer feed credit amounts, and performance of random spot checks. Eligible livestock producers submitted program applications at the FSA county office (CO) in the county and State where eligible livestock were headquartered. The producer certified to the number of eligible foundation herd livestock and selected a feed dealer from which supplemental feed would be obtained. A master listing of approved feed dealers was maintained by the Kansas City Commodity Office (KCCO) and was available at FSA COs and on the Internet. Based on the number of certified eligible livestock, FSA COs established a feed credit amount for each eligible livestock producer. The producer arranged with the designated feed dealer to exchange the feed credits for eligible livestock feed. FSA COs performed random spot checks to verify the accuracy of eligible livestock certifications.

Feed dealers electing to participate in the 2002 CFP were required to execute a Cattle Feed Program Agreement with the KCCO Bulk Commodities Division. The agreement included provisions that the supplied feed contain nonfat dry milk (NDM) made available from Commodity Credit Corporation (CCC) inventories and that the savings associated with use of NDM be passed on to the livestock producer. The agreement set forth restrictions associated with the distribution and use of NDM¹. NDM was priced at \$.01 per 55-pound bag and was off

¹ NDM acquired from CCC will only be used in feed made available to eligible producers specified by FSA under the CFP. The contractor shall report to CCC the quantity of NDM purchased from CCC that exceeds the quantities needed to make feed available under this agreement to eligible producers. After receiving approval from CCC, the contractor will be allowed to use such NDM in feed for sale to owners of foundation beef cattle but not for sale to any owner of any other type of livestock.

set from monthly invoices submitted by feed dealers to the Kansas City Finance Office (KCFO) for feed credits redeemed by livestock producers. CCC incurred the transportation costs associated with trucking the NDM from selected warehouse locations to requested delivery points.

KCCO received downloaded information from FSA COs as to producer certified numbers of eligible livestock, established feed credit amounts, and producer designations of approved feed dealers. KCCO was responsible for accepting feed dealer orders for NDM and arranging for transportation of the NDM to designated delivery points. KCFO was responsible for processing payment of monthly invoices submitted by approved feed dealers, including verification as to the amount of redeemed producer feed credits and offset charges for the cost of delivered NDM.

2003 Nonfat Dry Milk Assistance Initiative

Due to continuing drought conditions in 2003, additional stocks of NDM were allocated and distributed through the 2003 NDMA. The 2003 NDMA differed from the 2002 CFP in two major ways: (1) the 2003 assistance was administered by 12 State Departments of Agriculture and 7 Native American Tribal Governments, rather than the FSA; and (2) participating producers could elect direct distribution of the NDM, rather than receiving an NDM supplemented feed product through an approved feed dealer. Restrictions on the use/disposition of NDM included that CCC NDM could only be used for foundation livestock in the State of qualification; the producer could sell/exchange CCC NDM to acquire feed containing NDM; CCC NDM could not be used as a substitute for whey or whey products; NDM could not be used for human consumption; and third parties had to agree to the restrictions and certify to the disposition for the proper use of the NDM, and the products made from it.

FSA established the criteria for designating eligible States and Tribes. Each State and Tribal Government was provided with an allocation of NDM based on numbers of eligible foundation livestock as supported by National Agricultural Statistics Service figures and established feeding rations specific to individual animal types. NDM was provided to the State and Tribal Governments at a cost of \$1.00 per truckload, with CCC paying the cost to transport NDM from selected warehouses to distribution points designated by the State and Tribal Governments. KCFO invoiced State and Tribal Governments for the \$1.00 per truckload cost for delivered NDM. The State and Tribal Governments were responsible for determining producer eligibility and coordinating

with USDA for the delivery of allocated NDM. The individual State and Tribal Governments were allowed the flexibility to adjust recommended NDM feeding rations to extend coverage to livestock producers operating in counties affected by other than the most extreme drought conditions.

Each participating State and Tribal Government entered into a direct agreement with USDA. The agreement set forth specific restrictions associated with distribution and use of NDM, including that NDM was only to be used to feed foundation livestock, NDM was to be fed within the borders of an eligible State, and that NDM was not to be used for human consumption. Each State and Tribal Government also executed a Multi-State Agreement, which allowed for the transportation of NDM throughout the 12 eligible States and 7 Tribal boundaries.

Each State and Tribal Government established its own system for accepting producer applications and designating approved feed dealers. The States and Tribal Governments coordinated with KCCO in placing orders and designating delivery points for allocated quantities of NDM. Producers were allowed the flexibility to receive NDM directly or through a designated feed dealer. In addition, producers were afforded the opportunity to barter their allocation of NDM for a minimum price of \$80.00 per ton. The States and Tribal Governments were responsible for monitoring compliance by producers and feed dealers. FSA maintained responsibility for monitoring compliance by third party entities (e.g. participating feed dealers, non-participating feed dealers, commodity brokers, etc.) involved in the purchasing and selling of USDA NDM through the bartering transactions enacted by the State and Tribal Governments.

KCCO tracked the total amount of NDM ordered by each State and Tribal Government and coordinated the deliveries of NDM to designated delivery points. KCCO also established a plan to conduct compliance reviews on approximately 5 percent of the distributed NDM and 1 percent of the designated delivery locations. The Warehouse License and Examination Division (WLED) of KCCO was responsible for selecting sites and performing compliance reviews. As of November 2004, approximately 330 million pounds of NDM was distributed through the 2003 NDMA.

Livestock Compensation Programs

The 2002 LCP was an emergency initiative that provided cash payments to eligible owners and cash lessees of certain types of livestock. Eligible States and counties included those designated by the

Secretary of Agriculture as primary disaster areas for damages and losses due to drought between January 1, 2001, and September 19, 2002. Eligible producers included those with livestock operations headquartered in States and counties with qualifying disaster designations. Eligible livestock included beef and dairy cattle, sheep, goats, buffalo and beefalo. LCP payments were based on standard feed consumption rates for each eligible type of livestock. LCP was administered in 2,149 counties, with eligible livestock producers receiving over \$857 million in payments.

Following passage of the Agricultural Assistance Act of 2003, the 2002 LCP was expanded (LCP-II) to make additional counties eligible based on Presidential declarations for major events and emergencies taking place through February 20, 2003. USDA estimated that over 700 additional counties were designated eligible for assistance under LCP-II. Assistance payments under LCP-II totaled over \$230 million.

Objectives

The objective of our review was to determine whether internal controls were in place and functioning as intended to ensure that assistance afforded livestock producers was made available to eligible producers for intended purposes of providing supplemental feed for eligible livestock herds. We also evaluated a request from a U. S. Congressman regarding the appropriateness of payments issued under LCP-II. The Congressman was concerned that livestock producers may have received unwarranted benefits for disasters that did not result in actual losses to their livestock operations.

Findings and Recommendations

Section 1. Controls Not Adequately Established Over the Distribution of Nonfat Dry Milk for Livestock Feed Assistance

FSA did not establish sufficient or effective controls to ensure that distributions of NDM through the 2002 CFP and 2003 NDMA were in fact used for the intended purpose of providing a protein supplement for livestock feed. We noted that excessive distributions of NDM distributed through both the 2002 CFP and 2003 NDMA, combined with authorized bartering provisions for the 2003 NDMA, resulted in the creation of a secondary marketplace through which NDM was purchased and sold for ever increasing profits. We also noted that FSA did not provide adequate guidance or funding to facilitate effective administration of the 2003 NDMA by State and Tribal Governments.

Finding 1

NDM Diverted for Non-Program Uses into Secondary Markets

The Secretary of Agriculture instituted the 2002 CFP and the 2003 NDMA to help livestock producers in States severely impacted by drought. Through these initiatives, FSA distributed some of the Government's stock of NDM to feed dealers. Our reviews of the 2002 CFP and the 2003 NDMA disclosed that FSA had not instituted controls adequate to ensure that feed dealers ordered only the NDM they needed to supplement feed for producers in their area. Specifically, FSA did not (1) provide for coordination between KCCO divisions to ensure that orders of 2002 NDM submitted by feed dealers were reasonable; (2) correctly estimate the amount of NDM that could be effectively used for the 2003 NDMA; (3) consider the consequences of allowing producers to barter their 2003 allotments of NDM; (4) evaluate the capability of feed dealers to store NDM and manufacture feed containing NDM and limit delivery of NDM to such locations; (5) timely initiate the performance of compliance reviews to insure that NDM was used for intended purposes; and (6) establish a workable and realistic system of penalties and sanctions for noncompliant producers and feed dealers. Noted deficiencies in the establishment of internal controls resulted in feed dealers selling NDM on secondary markets rather than just using it to provide a low-cost supplement to feed provided to livestock producers in drought-stricken areas. We identified situations where NDM was shipped to locations outside those States eligible for livestock feed assistance (including foreign countries), and incorporated into products that may have ended

up in the human food chain. Furthermore, there was reduced assurance that the eligible foundation livestock herds utilized NDM.

Requests for NDM Not Checked for Reasonableness

During the 2002 CFP, feed dealers ordered far more NDM than they could reasonably use for program purposes. Excessive orders for 2002 NDM were not initially identified due to a separation of program responsibilities and lack of shared program information between divisions of FSA. As a result, excess NDM was distributed and stock piled, and in some cases eventually found its way into secondary markets.

For example, one feed dealer ordered 274 truckloads (11.6 million pounds) of NDM. Based on 2,087 head of cattle from those participating producers who elected to purchase feed from this feed dealer and using 5 pounds of NDM per day for the 40-day feeding period, this feed dealer should have ordered no more than 417,400 pounds (10 truckloads) of NDM. The feed dealer subsequently sold 2,000 tons of NDM on the secondary market at a price of \$100 per ton. The feed dealer purchased the NDM for \$.01 per 55 pound bag.

We also noted that orders for 2002 NDM were processed through the Dairy and Domestic Operations Division of KCCO. This division was responsible for verifying that feed dealers were approved to participate in the program, but did not have ready access to information supporting the numbers of participating producers electing to receive feed credits from each approved supplier or the number of certified eligible livestock. This information was downloaded to another KCCO division from the agency network of FSA county offices. Coordination among the divisions and sharing of information should have provided a basis for early identification of excessive orders of NDM, thus preventing the over distribution of NDM into secondary markets.

We also noted that FSA did not effectively utilize NDM delivery information and invoices submitted for payment to detect potential program abuse by feed dealers who provided cattle feed to producers in exchange for feed credits. KCFO evaluated invoices submitted by feed dealers to verify the amount claimed against established producers feed credits to prevent overpayments. However, KCFO was not necessarily familiar with the operational details of the 2002 CFP and did not review feed dealer invoices to (1) evaluate the reasonableness of the quantity of NDM in the feed, (2) whether the

cost savings realized by feed dealers was being passed on to CFP participants, and (3) that producers were charged consistent rates for feed products they received.

For example, the invoices submitted by one feed dealer showed that the feed supplied to seven of eight producers would have had to contain 100 percent NDM based on the number of bags claimed to have been used. Additionally, the invoices showed this dealer had charged the producers varying prices for feed containing 100 percent NDM in violation of its feed dealer agreement² (ranging from \$11.50 per ton to \$97.50 per ton). Thorough analysis of the information included on the feed dealer invoices should have raised questions related to the quantities of NDM ordered and used by participating feed dealers.

Quantities of NDM that Could be Effectively Used for the 2003 NDMA

For the 2003 NDMA, FSA provided an allotment of NDM to participating States and Tribes based on the number of eligible livestock in the State per National Agricultural Statistics Service statistics, and established NDM feeding rations of 2 pounds per day for cattle and bison and .5 pound per day for sheep and goats over the 30-day feeding period. These allocations resulted in excessive quantities of NDM being distributed and concentrated in certain locations and/or sold because many feed dealers could not incorporate all the NDM into feed. For example, one Nebraska feed dealer stated that only between 2.5 percent and 5 percent NDM was needed for the feed pellets he manufactured. Based on a daily feed ration of 40 pounds for cattle, only 1 pound of NDM would be used at the 2.5 percent level.

Bartering Provision in 2003 NDMA Created Secondary Market for NDM

Bartering provisions instituted for the 2003 NDMA caused concentrations of feed in certain locations that ended up being sold on the secondary market. The barter provisions allowed producers to obtain at least \$80 per ton for their allotments of NDM from feed dealers or third parties that they could use to purchase other livestock feed in a usable form. For example, one feed dealer stated that in order to keep his customers for the 2003 initiative, he accumulated a 3 to 4 year supply of NDM instead of the 1 year supply needed to

² Cattle Feed Program Agreement, Form FSA 552.

incorporate NDM into feed. The feed dealer stated he had to rent additional warehouse space to store NDM in inventory. The feed dealer subsequently sold 93 truckloads or 1,900 tons of 2003 NDM to a commodity broker on the secondary market. We noted other approved feed dealers bartered for NDM not only from their own customers, but also other feed dealers that had excess NDM or the rights to NDM. We found that one feed dealer credited its customers up to \$140 per ton for USDA NDM. Even at \$140 per ton, NDM was cheaper than the market price of other feed components having a similar protein such as soy meal, but which was valued at over \$200 per ton during the same period. We noted that the market values of feed ingredients increased dramatically during the 2003 NDMA program resulting from adverse crop conditions. These market conditions further exacerbated the incentive for feed dealers to sell NDM on the secondary market.

Feed Dealer Facilities Not Inspected Prior to Shipment of NDM

FSA did not screen feed dealers to determine if they had the facilities to store NDM or incorporate it into livestock feed. For example, one feed dealer requested delivery of 310 truckloads of NDM to a location where most of NDM was stored outside where it was susceptible to adverse weather conditions and spoilage. A second feed dealer requested delivery of 222 truckloads of NDM, all of which was stored outside. Several feed dealers who obtained NDM stated it was difficult to incorporate into feed and very hard on machinery. One feed dealer stated bearings on mixing machinery had to be replaced twice as often when mixing NDM into livestock feed. Another feed dealer stated NDM created so much dust when mixed into feed that complaints from the community were received, requiring relocation of the mixing operations to remote locations.



Photo of Excess NDM

In evaluating the capabilities of feed dealers to store and mix NDM, we noted that FSA granted waivers to about one third of the approved feed dealers under the 2002 CFP from the requirement NDM had to be included in cattle feed. The justifications offered for requesting waivers included lack of storage space, unavailability of feed manufacturing equipment, and lack of sufficient financial resources. The volume of waivers requests received and granted, combined with the justifications provided, should have served notice for FSA to question the reasonableness of distributing NDM for incorporation into livestock feed.

FSA also did not limit feed dealers to accepting deliveries of NDM at specified business locations maintained by the feed dealer. Under both the 2002 CFP and the 2003 NDMA, feed dealers were allowed to designate alternate delivery points or change delivery destinations up through the point of contact with the transportation company responsible for delivery of NDM. Other than relying on the integrity of the feed dealer, FSA had no assurance that NDM was delivered to eligible locations for authorized purposes. We also noted that FSA had not developed a strategy or plan for assuring the proper disposition of excess NDM on hand at feed dealers at the conclusion of the 2002 CFP. For the 2003 NDMA program, FSA encouraged feed dealers with excess NDM, from the preceding program, to notify participating States and Tribal Governments that NDM was available for use in augmenting their established allocations.

Internal Controls Instituted by FSA since the Initiation of the 2002 CFP and 2003 NDMA

FSA did not originally establish a compliance plan during the 2002 CFP to perform site visits of feed dealer locations to verify the delivery and use of NDM as a protein supplement for livestock feed. In response to allegations of improper distribution and use of NDM, FSA developed a compliance review plan that called for inspection of only 1 percent of the delivery point locations and 5 percent of the distributed NDM during the 2003 NDMA. USDA received reports that as much as 22,000 metric tons of NDM allocated for livestock feed assistance was exported to Europe, with implications related to the General Agreement on Tariffs and Trade. Also, there were complaints about and evidence of NDM being shipped to Mexico, labeled as food product, with potential for violation of the North American Free Trade Agreement. (See Finding 6, case currently under investigation.)

Lack of Penalties and Sanctions Encouraged Feed Dealers to Request Additional Stocks of NDM

FSA did not establish an effective system of penalties and sanctions for identified cases of noncompliance by feed dealers under the 2002 CFP or the 2003 NDMA. For example, feed dealers maintaining excessive quantities of 2002 NDM could only be encouraged, and not required, to donate excess NDM to State and Tribal Government programs as the feed dealers legally owned the NDM based on their purchase price of \$.01 per bag. The Office of the General Counsel stated that producers and feed dealers found to be noncompliant with provisions of the 2002 CFP could be required to repay the value of the improperly distributed and used NDM established at the rate of \$.01 per bag rather than the market value or the CCC acquisition and donation costs for the NDM. No provisions for assessment of liquidated damages were established, nor were specific criminal and civil statutes or penalties referenced in program contracts or agreements with the feed dealers even though they were required to certify compliance with program provisions in the forms they signed.

With respect to the 2003 NDMA, FSA was limited in its authority to apply penalties or sanctions against feed dealers, because USDA did not enter into direct agreements with the feed dealers. Under the 2003 NDMA, USDA entered into agreements with the State and Tribal Governments, who in turn entered into agreements with

approved feed dealers. This chain of agreements presented difficulties with respect to USDA pursuing corrective action against feed dealers, particularly related to pursuit of potential criminal prosecution. KCCO personnel stated they did not have authority to initiate punitive actions against program violators under the 2003 NDMA. KCCO personnel believed their only available recourse towards noncompliant feed dealers was to discontinue future deliveries of any NDM requested for delivery to sites operated/used on behalf of the identified feed dealers.

2004 Nonfat Dry Milk Livestock Feed Assistance Initiative

On July 16, 2004, the Secretary of Agriculture announced a 2004 Nonfat Dry Milk Livestock Feed Assistance Initiative that provided for additional distributions of NDM through State Departments of Agriculture and Native American Tribal Governments. While the basic delivery system resembled that which was established for the 2003 NDMA, a number of changes were enacted to help address problem areas identified during review of the 2002 CFP and the 2003 NDMA. Notable changes include a reduction in the allocated quantity of NDM for each State and Tribal Government, direct agreements between CCC and designated feed dealers that specified how the NDM was to be distributed and used, and identification of the specific locations to which NDM would be delivered. The agreements also included provisions for assessment of liquidated damages and applicability of civil and criminal penalties.

While these changes should have improved the distribution of NDM for supplemental livestock feed assistance, additional analysis would be needed to determine whether additional control measures were necessary to further improve the allocation and distribution of NDM in achieving Departmental goals.

Since the implementation of the 2004 NDMA initiative, the amount of available inventory quantities of NDM has been dramatically reduced. FSA officials do not currently foresee the continuance of using NDM for livestock feed assistance. However, no one can predict when and if future inventory quantities of NDM will become available. Therefore, we believe that now is the time for FSA officials to evaluate the lessons learned from the previous livestock feed assistance programs and develop strategies in case NDM again becomes available for future livestock programs.

Recommendation 1

For any future livestock feed programs involving feed credits and the distribution of NDM as a protein supplement, develop sufficient internal operating procedures to ensure there is coordination among FSA divisions so that the amount of NDM requested is consistent with NDM allocation based on livestock numbers and with NDM amounts transported.

Recommendation 2

Perform a post operational review of the 2002 CFP and the 2003 and 2004 NDMA Initiatives and develop recommendations for future NDM assistance programs based on an analysis of best practices/lessons learned. The review should consider the amount of NDM that can realistically be incorporated into livestock feed products and the effectiveness of the bartering provisions on the Departmental goal of providing a protein supplement for livestock feed. Use this information in determining reasonable allocations of NDM for distribution to producers in order to mitigate the potential amount of unused NDM available for unauthorized uses.

Recommendation 3

Develop standards and institute an approval process for feed dealers similar to that for approved USDA warehouses, including pre-approval visits, to ensure that feed dealers have the facilities and resources to effectively incorporate NDM into livestock feed.

Recommendation 4

Establish a compliance review program including examination procedures that provides for periodic inspection of a sufficient number of feed dealer sites to ensure proper accountability and use of NDM, including record keeping requirements for sales of NDM on secondary markets. This program should include procedures for determining the amount of unused NDM on hand at suppliers at the conclusion of each program and monitoring the proper disposition of any excess NDM quantities.

FSA Response.

Due to urgent needs relating to Hurricanes Katrina and Rita, the Deputy Administrator for Commodity Operations has been required to shift

many resources to handle the response to these devastating events. Due to this shift of resources, it could not provide comments to these recommendations.

OIG Position.

Since FSA could not provide comments to these recommendations, we are unable to reach management decision on these recommendations. In order to reach management decision, we need the agency's comments as to its concurrence or non-concurrence with the recommendations, corrective actions taken or planned, and timetables for implementing the corrective actions.

Finding 2

Guidance Needed for Effective State and Tribal Administration of the Nonfat Dry Milk Initiatives

Under the 2003 NDMA, FSA delegated authority for administering certain aspects of the assistance to the participating State and Tribal Governments. We noted that the State and Tribal Governments did not consistently administer the 2003 NDMA or encountered problems with (1) the bartering provision, which allowed producers to barter their allocation of NDM for a minimum value of \$80 per ton, and the development of State and Tribal agreements with feed dealers, (2) adjustments of recommended daily feeding rations and designations of additional eligible counties, and (3) inconsistencies in developing and carrying out compliance activities. Problems in these areas occurred because FSA delegated authority for administering the assistance to these entities without either adequate funding or sufficient direction to carry out these responsibilities. Ineffective administration of livestock feed assistance functions by State and Tribal Governments reduced the level of assurance that livestock certifications were accurate and that NDM was properly distributed for authorized purposes.

Under the 2003 NDMA, FSA executed agreements³ for State and Tribal Governments to administer the assistance. Under the 2003 NDMA, the State and Tribal Governments were responsible for establishing eligibility requirements for producers, ensuring that only

³ Each participating State Department of Agriculture and Native American Tribal Government entered into a direct agreement with the USDA. The agreement set forth specific restrictions associated with distribution and use of the NDM, including that the NDM was only to be used to feed foundation livestock, the NDM was to be fed within the borders of an eligible State, and that the NDM was not to be used for human consumption. The States and Tribes also executed a Multi-State Agreement, which allowed for the transportation of NDM throughout the 12 eligible States and seven Tribal boundaries.

producers of foundation herd livestock received NDM, and requesting NDM from USDA. FSA was responsible for supplying NDM and directing the transportation of NDM to the requested delivery location. Also, FSA was responsible for enforcing limits on third party use of NDM if NDM was bartered.

Bartering Provisions and Agreements with Feed Dealers

The State and Tribal Governments instituted a bartering provision which allowed producers to barter their allocation of NDM for a minimum value of \$80 per ton, which they could then use to purchase feed of their choosing, with or without NDM. As discussed in Finding 1, the bartering provision was a significant factor in the emergence of a secondary market within which USDA NDM was bought and sold for profit. The emergence of this secondary market resulted in NDM being diverted from its intended purpose; in some cases, NDM was shipped to ineligible locations, including locations outside the United States, and for ineligible purposes including incorporation into human food products. The bartering provision remained in effect for the 2004 NDM Initiative.

Although FSA was responsible for enforcing limits on the third party use of NDM, it did not have a direct agreement with participating feed dealers, and thus, was limited in its ability to initiate action relative to suspected or identified violations of restricted use provisions associated with the distribution and use of NDM. We also noted that feed dealer agreements developed by State and Tribal Governments did not always detail or properly refer to the USDA restrictions on distribution and use of NDM.

For example, a feed dealer headquartered in Idaho contracted to sell NDM to a non-feed company headquartered in Utah. The Idaho feed dealer ordered 10 million pounds of NDM and had it delivered to business locations in Salt Lake City and Ogden, Utah. The Idaho feed dealer did not have any feed manufacturing facilities in Utah. The contract with the State of Idaho stipulated that the feed dealer comply with all USDA and State restrictions on the use of NDM. However, NDM delivered to the two business locations in Utah was mixed with other ingredients and shipped to locations outside the United States under contracts with the non-feed company. The non-feed company, and its activities involving NDM from NDMA, was referred to the Office of Inspector General (OIG) Investigations. (See Finding 6 for discussion of improper agency follow-up on allegation of potential program abuse related to this case.)

An interview with the manager of the Utah non-feed company revealed that he had contracted to have NDM re-bagged, or mixed with other ingredients and bagged for shipment. During the interview, the manager stated that 100 percent of the product left the United States; with 50 percent shipped overseas, and 50 percent transported to Mexico. In addition, some of the products were labeled “Preparation Alimenticia”, translated as “Food Blend”.

FSA was limited in its ability to initiate administrative action against the third party responsible for blending NDM into a food product and exporting it outside the country as the agency did not hold a binding agreement with the third party purchaser of NDM or the feed dealer who sold NDM to the third party. Effective for the 2004 NDM Initiative, FSA instituted direct agreements with the feed dealers.⁴ The agreement specifies the restrictions on the use of NDM released under the initiative, which addresses our concern about the variances in feed dealer agreements developed by the States and Tribal Governments.

Daily Feed Ration

In some cases, States and Tribes adjusted the USDA recommended daily feeding ration of NDM for eligible livestock and offered expanded eligibility to producers in additional counties impacted by drought conditions. As such, producers in various States and Tribes did not receive equal benefits under the 2003 NDMA.

For example, one State NDM coordinator said his/her State reduced the standard feeding allocation from 2 pounds to 1.8 pounds per day for beef cattle and buffalo and from .5 pounds to .45 pounds per day for sheep and goats. This reduction occurred because the State added seven counties that were not designated as D4⁵ exceptional drought counties. As a result, producers in that State received feed allocations equal to 90 percent of the nationally established standard. The total NDM allocated to this State was about 66 million pounds, of which 6 million pounds were allocated to 1,117 producers in the seven added counties.

For the 2004 NDM Initiative, the Memorandum of Understanding between CCC and the States and Tribes specifies that the States are now responsible to “only provide NDM released under this Memorandum to producers with eligible livestock in eligible

⁴ Nonfat Dry Milk Restricted Use Sales Agreement.

⁵ The drought monitor, a synthesis of multiple indices, outlooks, and news accounts is used to detect and monitor droughts. The intensity of the drought ranges from D 0 (abnormally dry) to D 4 (drought-exceptional).

counties, as determined under the 2004 NDM Livestock Feed Initiative.”⁶ This restriction should ensure equality of producer benefits from State to State.

Inconsistencies in Compliance Programs

Although State and Tribal Governments were responsible for the performance of compliance activities to ensure the accuracy of producer certifications of eligible livestock, the extent of planned compliance activities varied from development and selection of a random sample of livestock certifications to be verified to no planned compliance checks. USDA did not provide any guidance or requirements relative to development and execution of a compliance plan; neither did USDA provide any funding for State or Tribal use in developing a compliance plan. Most, if not all, were affected by lack of available funding.

2004 Nonfat Dry Milk Livestock Feed Assistance Initiative

The 2004 NDM Initiative still does not adequately address or provide resources to facilitate State and Tribal Government performance of compliance functions to ensure the integrity of program operations. In addition, FSA has not performed any studies or reviews to evaluate the effectiveness of State and Tribal administration of either program.

Recommendation 5

For future livestock feed assistance initiatives where State and Tribal Governments are responsible for administering aspects of the assistance, develop specific requirements and performance measures for coordinating compliance functions based on evaluating past performance. Also, evaluate alternatives for providing or delegating resources (staff and funding) at the Federal level to accommodate the accomplishment of these required functions and select the alternative that represents the best use of available resources and assures program integrity.

FSA Response.

Due to urgent needs relating to Hurricanes Katrina and Rita, the Deputy Administrator for Commodity Operations has been required to shift many resources to handle the response to these devastating events. Due

⁶ Memorandum of Understanding Between the CCC and the State of (Name of Participating State) Regarding Sales of NDM, Paragraph 2A.

to this shift of resources, it could not provide comments to this recommendation.

OIG Position.

Since FSA could not provide comments to this recommendation, we are unable to reach management decision on this recommendation. In order to reach management decision, we need the agency's comments as to its concurrence or non-concurrence with the recommendation, corrective actions taken or planned, and timetables for implementing the corrective actions.

Section 2. Livestock Compensation Payments

We noted that livestock operations effected by non-drought related disasters received the same livestock compensation payment rate as livestock operators in counties designated as disaster areas due to long-term drought conditions. The payment rate initially established for LCP was based on economic analysis of the long-term conditions in drought-related counties. However, when LCP-II expanded the eligibility to all counties designated as disaster areas, the same livestock compensation payment rate was applied to eligible livestock operations in drought and non-drought related disaster areas. We also noted that program applications submitted by USDA employees were not always subject to appropriate approval authority and that random spot checks were not always properly selected or completed.

Finding 3

Proof of Loss or Economic Analysis Needed to Ensure Livestock Payments Are Commensurate with the Loss Incurred

The original LCP provided program assistance to eligible livestock operations in eligible counties designated for drought-related damages. Since the LCP payment rates were tied to an economic analysis of the effect of long-term drought conditions had on livestock operations, producers qualified for LCP payments without a requirement for the producers to show a proof of loss or the actual affect the qualifying disaster had on their herds. However, when the LCP-II program was announced, livestock operations in any county declared as a disaster area by the Secretary or President became eligible and the qualifying disaster did not have to relate to drought conditions. This occurred because agency officials interpreted the Agricultural Assistance Act of 2003 as restricting the eligibility requirements under LCP-II to the requirements under LCP, except for expanding the number of eligible producers. As a result, producers whose livestock operations were headquartered in States and counties with qualifying disaster declarations, but were not affected by the qualifying events under the initial program, received LCP assistance at a rate equal to those producers whose livestock operations were affected by long-term conditions such as drought. Although the livestock operations in those counties not affected by long-term drought may have been affected by the qualifying disaster, there was no economic analysis performed to determine if the payment rate that the livestock operation received was comparable to the actual loss incurred. We noted that \$159 million in LCP-II payments were issued to livestock producers in States and counties that did not experience long-term drought conditions.

Under LCP, assistance was provided to livestock operations in eligible States and counties including those designated by the Secretary of Agriculture as primary disaster areas for damages and losses due to drought. To receive LCP payments, a producer was required to own or lease an eligible livestock operation physically located in an eligible county. Eligible counties were those designated by the Secretary of Agriculture as primary disaster counties for drought-related damages and losses incurred between January 1, 2001, and September 19, 2002⁷. FSA disbursed over 440,000 payments totaling approximately \$857 million in 2,142 counties in 42 States.^{8,9}

Language included in the Agricultural Assistance Act of 2003¹⁰ expanded eligibility criteria for LCP-II to include any counties declared as a disaster by the Secretary or counties with Presidential disaster declarations related to major events or emergencies, not necessarily linked to losses associated with livestock operations. The statute defined a qualifying natural disaster as a natural disaster declared by the Secretary under Section 321 (a) under the Consolidated Farm and Development Act or a major disaster or emergency designated by the President under the Robert T. Stafford Disaster Relief and Emergency Assistance Act. FSA policy¹¹ provides that eligible counties and losses for LCP-II assistance include those with or for sustained damages and losses due to any natural disaster. With funds provided by the Agricultural Assistance Act of 2003, FSA issued over 130,000 LCP-II payments totaling about \$234 million in 2,464 counties in 50 States as well as in Puerto Rico.

For LCP, the analysis of the need for assistance to producers in certain States and counties to offset losses due to drought (OIG emphasis) was prepared by the USDA's Economic Research Service (ERS). The LCP payment rate was supported by analysis performed by ERS, including an evaluation of various long-term conditions and economic impacts that would not necessarily be measurable in lost head of livestock. When the Agricultural Assistance Act of 2003 expanded LCP to include other major events and emergencies that were short in duration (i.e. flood or storm), were not natural disasters (i.e. Space Shuttle Columbia disaster and terrorist attacks), or were not impacting on individual property (i.e. snow removal on public roads), no additional analysis was performed to determine how these events would/should impact the LCP payment rate. According to FSA officials, FSA was

⁷ The Secretary approved primary counties for disaster designation as requested by State Governors or Tribal Leaders of Indian reservations.

⁸ Funding for LCP-I was made available under section 32 of the Agricultural Adjustment Act Amendment of August 24, 1935.

⁹ Per LCP application data provided by the FSA Kansas City Commodity Office as of July 21, 2003.

¹⁰ Agricultural Assistance Act of 2003 dated February 20, 2003.

¹¹ Notice DAP 157; paragraph 2 B, dated March 27, 2003.

required to administer LCP-II under the same terms as LCP and therefore, it relied on the earlier economic analysis and payment rates. This resulted in producers whose livestock operations were located in States and counties with qualifying disaster declarations, but not directly impacted by the declared disasters, receiving assistance at the same rate as livestock producers whose operations were subject to prolonged drought conditions.

We analyzed disaster declarations for the eligible time frames encompassing LCP-II. We identified the disaster declarations as Secretarial vs. Presidential and the disaster conditions as drought vs. non-drought. Within our analysis, we identified approximately \$112 million paid to producers for Presidential declarations representing non-drought conditions. We identified an additional \$30 million paid to producers for combinations of Presidential and Secretarial declarations representing non-drought declarations, and another \$17 million paid to producers in counties with Secretarial declarations for non-drought conditions. In total, approximately \$159 million was paid to producers through LCP-II for non-drought conditions.

In our view, the LCP assistance should have been directed only to those in need. Additional eligibility requirements, such as proof of loss, should be specified to ensure the appropriateness of USDA payments or the payment rate should be tied to an economic analysis related to the qualifying disaster area/event.

Recommendation 6

In the future, use the Secretary's review authority and establish supplemental eligibility criteria for locations experiencing disasters, such as the submission by producers of proof of loss or by performing an economic analysis that ties the disaster payment rate to existing conditions within the eligible areas.

FSA Response.

FSA agrees that program benefits should not be provided to producers who do not meet the eligibility requirements of the program. FSA also agrees that Livestock Feed and Compensation Program benefits should be based on actual eligible losses incurred by eligible producers. Provided the statutory provisions authorizing the particular program provides the Secretary the authority to establish certain eligibility criteria and/or allows FSA to require proof of loss from producers, FSA will take all necessary steps to ensure program benefits are targeted to eligible producers who suffer eligible losses.

OIG Position.

We accept management decision for this recommendation. For final action, FSA needs to provide the Office of the Chief Financial Officer (OCFO) a copy of its reply to our official report.

Finding 4

LCP Application Approval Procedures Not Followed

LCP applications submitted by FSA and CO employees were not always subject to next higher-level approval authority as required by program procedure. Improper approval authority was attributed to a lack of understanding of LCP application approval requirements on the part of FSA employees. While we did not identify any ineligible applications to participate in LCP, proper approval authority is essential to support the integrity of program administration.

FSA procedures for LCP-I¹² and LCP-II¹³ provide that members of the county committee (COC) or designee shall approve or disapprove requests for LCP. The State office (STO) representative shall approve or disapprove requests submitted by CO employees, county executive directors and COC members. The Deputy Administrator, Farm Programs, shall approve or disapprove requests submitted by STO employees (including district directors), State executive director, and State committee members.

Our review of the LCP application approval process in seven counties in three States, disclosed discrepancies in the approval authority for applications submitted by FSA and county level employees in three counties in three different States. We identified an application submitted by a district director that was improperly approved by the State executive director and applications submitted by COC members that were improperly approved by the county executive director or other members of the COC.

We also noted an inconsistency in the application approval procedures for the 2002 LCP and the 2002 CFP. Whereas application approval procedures for the 2002 LCP required next higher-level approval authority, application approval procedures for the 2002 CFP did not. As these two programs were administered in approximately the same

¹² FSA Handbook 4-DAP, paragraph 9 C.

¹³ FSA Handbook 4-DAP, paragraph 33 D.

timeframe, CO personnel may have become confused or did not completely familiarize themselves with the differences associated with the two programs.

Recommendation 7

Issue a reminder to all COs to follow updated program procedures relative to approval authority for disaster program applications submitted by FSA and county level employees.

FSA Response.

FSA issued Notice Disaster Assistance Program (DAP)-234 to State and county FSA offices reminding them of the applicable procedures relative to approval authority for the 2003/2004 Livestock Assistance Program currently begin administered.

OIG Position.

We accept management decision for this recommendation. For final action, FSA needs to provide OCFO a copy of the cited notice evidencing its actions were completed.

Recommendation 8

Establish consistent application approval procedures for disaster programs, based on the next higher level of approval authority for applications submitted by FSA and county level employees.

FSA Response.

FSA agrees there should be one uniform application approval procedure for disaster applications submitted by FSA and county level employees. FSA will develop a uniform application approval process based on the next higher level of authority for disaster applications submitted by FSA and county level employees.

OIG Position.

We concur with the planned corrective actions. In order to achieve management decision, we need to know the timeframe when FSA will accomplish its proposed development and implementation of the uniform application approval process.

Finding 5**Spot Checks Not Timely Completed and Procedures for Determining the Number of Spot Checks Required Were Unclear**

Random spot checks of livestock certifications for the 2002 LCP and the 2002 CFP were not always properly selected or timely completed. The correct number of random spot checks to be performed was understated due to limiting the universe of approved program applications to a date prior to the end of the signup period. In addition, procedures did not specify whether FSA employee applications were supposed to be required spot checks or part of the random spot checks. Also, random spot checks were not timely completed due to overriding priorities with other program administration activities. Improper sample selections and untimely completion of spot checks reduce the effectiveness of spot checks as an internal control attesting to the correctness of producer livestock certifications.

LCP¹⁴ and CFP¹⁵ procedures required FSA COs to perform spot checks on no fewer than 5 percent of the approved program applications using the random selection method. Program procedures specified that spot checks were to be completed on no fewer than 5, but no more than 60, program applications. Spot checks were to be completed within 60 days of application approval. Program procedures further provided that spot checks performed for the 2002 CFP could also be used to fulfill spot check responsibilities for the 2002 LCP.

We reviewed the LCP and CFP spot check procedures administered in three States and seven counties. Our review disclosed discrepancies in the sample selection of applications for spot check in three of the seven counties visited. We noted instances where insufficient numbers of random sample selections were identified due to the fact that a complete universe of approved program applications was not available at the time the original sample selection was made. Procedures required that spot checks be performed within 60 days of application approval, despite the fact that the timeframe for submitting program applications exceeded 60 days. Thus, the spot check process was initiated prior to the final date for submission of program applications, resulting in an underestimation of the total number of required spot checks and eliminating some program applications from spot check consideration. We also identified an instance where a judgmentally selected sample of program applications submitted by FSA and CO

¹⁴ FSA Handbook 4-DAP, paragraph 10A.

¹⁵ Notice DAP-136, paragraph 3E.

employees was used to supplement an understated sample of randomly selected spot checks.

We noted that randomly selected spot checks were not timely completed in four of the seven counties visited. Of the 199 LCP applications randomly selected for spot check by the seven COs, only 122 were timely completed (61 percent). Of the 31 CFP applications selected for spot check by the three COs in Nebraska, 25 were timely completed (81 percent). Field level personnel attributed the untimely completion of spot checks to overriding priorities associated with the administration of other FSA programs. Timely conduct of spot checks is essential to provide meaningful analysis related to the accuracy of producer provided certifications of eligible livestock.

Recommendation 9

Revise program procedures to include a clear explanation of the methodology to be followed for manually selecting random samples of program applications for spot check, including a discussion on how to expand the sample selection process when spot checks must be initiated prior to the end of program sign up.

FSA Response.

The 2002 LCP, on which the findings and recommendation are based, is no longer an active program. There is currently no LCP being administered.

FSA is hopeful that as more programs are transitioned to a web-based format, the selection of program applications for spot check will be an automated process that can be triggered at the applicable time to ensure a true random sample of all applicable applications is selected. However, FSA will review current disaster program procedures relating to the spot-check selection process, and ensure such procedures provide a clear explanation of the methodology to be followed. FSA will also ensure the applicable procedures provide clear instructions relating to when and how the sample selection of applications should be expanded.

OIG Position.

We concur with the planned corrective actions. In order to achieve management decision, we need to know the timeframes for reviewing the disaster program procedures and modifying the applicable procedures, if necessary.

Recommendation 10

Clarify program procedures to specify whether applications submitted by FSA and CO employees are subject to the random sample selection process or constitute required spot checks to be completed in addition to the random sample selection process.

FSA Response.

The 2002 LCP, on which the finding and recommendation are based, is no longer an active program. There is currently no LCP being administered. However, FSA will review current disaster program procedures relating to spot-check selection procedures and ensure such procedures provide clear instructions relating to whether applications submitted by FSA and county office employees are subject to the random sample selection process or constitute required spot checks to be completed in addition to the random selection process.

OIG Position.

We concur with the planned corrective actions. In order to achieve management decision, we need to know the timeframes for reviewing the disaster program procedures and modifying the applicable procedures, if necessary.

Section 3. Potential Program Violations Not Referred to OIG

Finding 6

Referrals of Potential Program Abuse Not Always Subject to Appropriate Follow Up

We identified two instances where FSA personnel were advised of possible program violations involving the distribution and use of NDM and failed to followup or refer the allegations to the OIG, as required by Departmental regulations and FSA directives. Field personnel became aware of the potential program violations and initiated referral of the information through the agency chain of command. However; in the processing of the potential referral through the agency, the referrals were overlooked. We also noted that FSA had not established a formal tracking system to monitor the receipt, followup, and resolution of complaints, allegations, and referrals of potential improper acts. Subsequent followup on these referrals by OIG and KCCO personnel disclosed violations of the 2002 CFP and 2003 NDMA provisions related to authorized distribution and use of NDM released for supplemental livestock feed.

Department regulations¹⁶ provide that each USDA employee will report to OIG or proper officials any instances of known or suspected violations or irregularities in USDA programs. FSA Handbook 9-AO, Audits and Investigations, provides instructions to FSA employees to immediately report to OIG known or suspected illegal activities that in any way relate to their position or function.

In conjunction with our review of the 2002 CFP, we identified a feed dealer in Nebraska that requested delivery of 10 truckloads of NDM to a location in Anthony, Kansas. In an effort to verify whether NDM was intended for cattle normally headquartered in Nebraska, or the NDM was to be mixed into a livestock feed product and returned to Nebraska for feeding purposes, we contacted the FSA county executive director (CED) on October 17, 2003, to obtain information about the Kansas producer and livestock operation designated as the delivery point for NDM. The CED verified that producers in the State of Kansas were not eligible to receive assistance under the 2002 CFP and yet the producer had received and fed NDM to livestock located in Kansas. The CED provided documentation to show that on February 28, 2003, her findings were referred to the Kansas State FSA Office for information and followup. Representatives of the Kansas State FSA Office contended the information was subsequently

¹⁶ Departmental Regulation 1700-2, section 7 f (2), June 17, 1997.

forwarded to FSA Headquarters, although we were not provided any documentation to support a formal referral of the reported information. Through follow up interviews, we determined that the feed dealer had improperly ordered 21 truckloads of NDM for delivery to three livestock producers who were not eligible to receive assistance under the 2002 CFP. Transportation costs for the 21 truckloads of NDM delivered to the three ineligible producers totaled \$18,747.

In conjunction with our review of the 2003 NDMA, we contacted the participating State Departments of Agriculture and Native American Tribal Governments to determine the actions planned or intended with respect to evaluating producer and feed dealer compliance with provisions related to the distribution and use of 2003 NDM. Through these contacts, we identified a referral from the Utah Department of Agriculture to the Dairy and Domestic Operations Division of KCCO, dated October 31, 2003, alleging improper distribution and use of NDM within the State of Utah and providing a specific address where suspected improper activity was taking place. Inquiry with representatives of KCCO disclosed that the referral had been overlooked and not timely acted upon. In response to our inquiry, KCCO and OIG coordinated in a joint examination of facilities referenced in the Utah referral to establish the quantities and condition of NDM on hand, as well as the intended use of NDM. The joint examination was conducted in January 2004, and ultimately resulted in the identification of a company involved in the blending of NDM into an alternate food product that was exported to foreign countries, possibly incorporated into human food products. This case is currently under investigation for possible civil and/or criminal prosecution.

Throughout the course of our review, we coordinated with KCCO in exchanging/sharing information related to potential violations of the program/assistance provisions related to distribution and use of allocated NDM. Through this sharing of information, we became aware that agency personnel at various levels received an unspecified number of other inquiries and complaints related to alleged improper distribution and use of NDM, and in many cases, we were provided follow up information related to the reviews and findings by agency personnel. While inquiries and complaints related to the distributions and use of NDM were primarily routed to the Warehouse Licensing and Examination Division (WLED) of KCCO for analysis and follow up, no formal tracking system was developed and maintained by WLED to ensure that all inquiries and complaints received proper attention.

As agency personnel did not establish a formal tracking system for receipt and resolution of these inquiries, we were not able to quantify the number of referrals/complaints received or place the lack of timely follow up for these two specific cases in perspective.

Recommendation 11

Establish and maintain a formal tracking system for receipt, follow up, and resolution of complaints, allegations, and referrals at KCCO.

Recommendation 12

If collectible, initiate administrative action against the feed dealer to recover the transportation costs associated with 21 truckloads of NDM improperly ordered by a Nebraska feed dealer and delivered to three producers who were not eligible for 2002 CFP benefits.

FSA Response.

Due to urgent needs relating to Hurricanes Katrina and Rita, the Deputy Administrator for Commodity Operations has been required to shift many resources to handle the response to these devastating events. Due to this shift of resources, it could not provide comments to these recommendations.

OIG Position.

Since FSA could not provide comments to these recommendations, we are unable to reach management decision on these recommendations. In order to reach management decision, we need the agency's comments as to its concurrence or non-concurrence with the recommendations, corrective actions taken or planned, and timetables for implementing the corrective actions.

Scope and Methodology

The scope of our review included the 2002 CFP, the 2003 NDMA, and the livestock compensation programs (LCP and LCP-II). Within the 4 eligible States for the 2002 CFP, approximately 50,000 livestock producers received nearly \$137 million in feed credits for about 6 million head of livestock. A total of 242 million pounds of NDM was shipped to over 1,800 feed dealers for the 2002 CFP and transportation costs associated with these distributions of NDM totaled over \$6 million. The 2003 assistance was administered by 12 State Departments of Agriculture and 7 Native American Tribal Governments and approximately 330 million pounds of NDM was distributed through November 2004. The LCP was administered in 2,149 counties, with eligible livestock producers receiving over \$857 million in payments. LCP-II was expanded to make over 700 additional counties eligible and LCP-II payments totaled over \$230 million.

To accomplish the review objectives, we gained an understanding of the 2002 CFP, the 2003 NDMA, and the 2002 LCP administered by USDA FSA. We reviewed applicable laws, regulations, policies, and procedures developed by USDA related to distributions of NDM to approved feed dealers, State Departments of Agriculture, and Native American Tribal Governments for supplementing livestock feed and disbursements of cash payments to livestock producers for losses associated with designated disaster conditions. We conducted our review through interviews of personnel representing FSA, State Departments of Agriculture, Native American Tribal Governments, feed dealers, and individual livestock producers. We also reviewed records provided by each respective source to substantiate or refute verbal statements and to establish the sequence of transpired events. We performed the audit fieldwork during the period July 2003 through November 2004.

We performed our review of the 2002 CFP through interviews of FSA personnel and reviews of program records at two STOs and three COs (see exhibit B for listing of STOs and COs). STOs were judgmentally selected based on volumes of NDM distributed through the 2002 CFP. COs were judgmentally selected based on levels of producer participation, quantities of NDM requested by area feed dealers, and recommendations by STO personnel. At each CO, we evaluated program documents for 10 judgmentally selected producers based on numbers and location of certified eligible livestock. We reviewed

name, address, identification number and business organization information to ensure producers had not received unearned benefits. We also evaluated field level procedures for selecting and performing spot checks of certified eligible livestock.

We obtained database files from KCCO summarizing producer designations of approved feed dealers, including individual producer feed credit amounts, payments to approved feed dealers, and quantities of NDM transported to approved feed dealers for the 2002 CFP. We used the database records to identify potentially excessive quantities of NDM ordered by approved feed dealers and we judgmentally selected six feed dealers in Nebraska and Wyoming for review. We interviewed personnel, reviewed records, and examined the storage condition of NDM maintained in inventory. We also confirmed that information on the three database files obtained from KCCO, specifically with regard to feed dealer selection by producers, producer feed credits amounts on submitted invoices and amounts of 2002 NDM delivered to dealers was in agreement with documents obtained from feed dealers. We interviewed personnel from KCFO to gain an understanding of the process by which producer redeemed feed credits were invoiced to KCFO for reimbursement of feed dealer expenses.

We evaluated administration of the 2003 NDMA through interviews of personnel representing three State Departments of Agriculture and one Native American Tribal Government (see exhibit B for listing of offices reviewed). We also reviewed applicable records related to the designation of State-approved feed dealers, allocation of producer feed credits, and the distribution of NDM to designated delivery points. We reviewed the KCCO plan for performing compliance reviews of NDM quantities and delivery points. We accompanied KCCO personnel in performing compliance reviews for eight approved feed dealers in Kansas, Nebraska, and Utah. During these site visits, we interviewed feed dealer personnel, reviewed records, and performed physical inventories of NDM on hand to reconcile quantities of NDM that were ordered, shipped, and used by the feed dealers. We also teamed with KCCO personnel in performing follow up on two alleged cases of misappropriated NDM within the State of Utah.

We evaluated FSA administration of the 2002 LCP through interviews of FSA personnel and reviews of program records at three STOs and seven COs (see exhibit B for identification of STOs and COs visited). STOs and COs were judgmentally selected based on dollar value of LCP payments issued under the original and expanded eligibility criteria. STOs were consulted in selecting COs for review. At each CO, we evaluated program documents for 10 judgmentally selected

program participants based on the number and location of certified eligible livestock. Sample selections were completed using LCP payment information obtained from the Kansas City Information Technology Services Division, CO LCP registers, producer earnings reports, and LCP producer payment history reports. Producer name, address, identification number, and business organization information was reviewed to ensure producers were eligible for the LCP payments. We also evaluated field level procedures for selecting and performing spot checks of certified eligible livestock.

As a result of a congressional inquiry, we obtained database files from the Kansas City Information Technology Services Division summarizing program payments issued at the State and county levels under the original and expanded eligibility criteria for the 2002 LCP. The LCP database files were built using approved participant application information uploaded to the Kansas City Information Technology Services Division from participating FSA COs. We reviewed information related to the Secretarial and Presidential disaster declarations to verify the eligibility of States and counties for LCP assistance and used the developed information to evaluate and respond to a Congressional inquiry regarding the appropriateness of payments issued under expanded eligibility criteria.

Throughout the review, OIG coordinated with FSA personnel in conducting compliance reviews of distributed NDM to designated feed dealers. OIG and KCCO personnel worked in concert to identify entities and individuals involved in suspected misappropriations of NDM. Through these collaborative efforts, shipments of NDM to identified entities and individuals were terminated and actions on the part of these entities and individuals were referred to OIG Investigations for pursuit of civil and/or criminal prosecution.

The review was performed in accordance with Government Auditing Standards.

Exhibit A – Summary of Monetary Results

Exhibit A – Page 1 of 1

Finding Number	Recommendation Number	Description	Amount	Monetary Results
6	12	Transportation costs for 21 truckloads of NDM delivered to ineligible producers	\$18,747	Questioned Costs, Recovery Recommended

Exhibit B – Sites Visited

Exhibit B – Page 1 of 1

<u>Assistance</u>	<u>State Level</u>	<u>County Level</u>
2002 CFP	Nebraska State FSA Office	Cuming County FSA Office Scotts Bluff County FSA Office
		Washington County FSA Office
	South Dakota State FSA Office	
2003 NDMA	Nebraska Department of Agriculture South Dakota Department of Agriculture Utah Department of Agriculture Cheyenne River Sioux Tribal Government	
2002 LCP	Nebraska State FSA Office	Cuming County FSA Office Scotts Bluff County FSA Office
		Washington County FSA Office
	Texas State FSA Office	Hopkins County FSA Office Milam County FSA Office
	Wisconsin State FSA Office	Grant County FSA Office Green County FSA Office

Exhibit C – Agency Responses

Exhibit C – Page 1 of 5

United States
Department of
Agriculture

Farm and Foreign
Agricultural
Services

Farm Service
Agency

Operations Review
and Analysis Staff

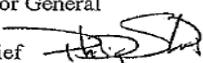
Audits,
Investigations, and
State and County
Review Branch

1400 Independence
Ave., SW
STOP 0540
Washington, DC
20250-0540



SEP 30 2005

TO: Director, Farm and Foreign Agriculture Division
Office of Inspector General

FROM: Philip Sharp, Chief 
Audits, Investigations, and State and County Review Branch

SUBJECT: Response to Official Draft: 03099-52-KC, Livestock Feed and Compensation Programs

With the urgent needs relating to hurricanes Katrina and Rita, the Deputy Administrator for Commodity Operations has been required to shift many resources to handle the response to these devastating events. Due to this shift of resources we cannot provide comments to recommendations 1 through 5 and 10 through 12 at this time.

The Deputy Administrator for Farm Programs has provided the following comments on recommendations 6 through 9:

Recommendation 6

The Farm Service Agency (FSA) agrees that program benefits should not be provided to producers who do not meet the eligibility requirements of the program. FSA also agrees that Livestock Feed and Compensation Program benefits should be based on actual eligible losses incurred by eligible producers. Provided the statutory provisions authorizing the particular program provides the Secretary the authority to establish certain eligibility criteria and/or allows FSA to require proof of loss from producers, FSA will take all necessary steps to ensure program benefits are targeted to eligible producers who suffer eligible losses.

Recommendation 7

FSA issued Notice DAP-234 to State and county FSA offices reminding them of the applicable procedures relative to approval authority for the 2003/2004 Livestock Assistance Program currently being administered.

Recommendation 8

FSA agrees there should be one uniform application approval procedure for disaster applications submitted by FSA and county level employees. FSA will develop a uniform application approval process based on the next higher level of authority for disaster applications submitted by FSA and county level employees.

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Exhibit C – Agency Responses

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Office of Inspector General
Page 2

Recommendation 9

The 2002 Livestock Compensation Program (LCP), on which the findings and recommendation are based, is no longer an active program. There is currently no LCP being administered.

FSA is hopeful that as more programs are transitioned to a web-based format, the selection of program applications for spot check will be an automated process that can be triggered at the applicable time to ensure a true random sample of all applicable applications is selected. However, FSA will review current disaster program procedures relating to the spot-check selection process, and ensure such procedures provide a clear explanation of the methodology to be followed. FSA will also ensure the applicable procedures provide clear instructions relating to when and how the sample selection of applications should be expanded.

Exhibit C – Agency Responses

Exhibit C – Page 3 of 5



United States
Department of
Agriculture

Farm and Foreign
Agricultural
Services

Farm Service
Agency

1400 Independence
Ave, SW STOP
0510
Washington, DC
20250-0510

TO: Philip Sharp, Chief
Audits, Investigations, and State and County Review Branch

FROM: *John A. Johnson* *Bradley Karmen* SEP 16 2005
Deputy Administrator for Farm Programs

SUBJECT: Response - Office of Inspector General (OIG) Official Draft
Audit Report 03099-52-KC, Livestock Feed and Compensation Programs
Your Memorandum of August 24

The following is in response to the subject audit for findings and recommendations applicable to DAFP for Livestock Feed and Compensation Programs:

Recommendation 6

In the future, use the Secretary's review authority and establish supplemental eligibility criteria for locations experiencing disasters, such as the submission by producers of proof of loss or by performing an economic analysis that ties the disaster payment rate to existing conditions within the eligible areas.

FSA Response

FSA agrees that program benefits should not be provided to producers who do not meet the eligibility requirements of the program. FSA also agrees that Livestock Feed and Compensation Program benefits should be based on actual eligible losses incurred by eligible producers. Provided the statutory provisions authorizing the particular program provides the Secretary the authority to establish certain eligibility criteria and/or allows FSA to require proof of loss from producers, FSA will take all necessary steps to ensure program benefits are targeted to eligible producers who suffer eligible losses.

Recommendation 7

Issue a reminder to all COs to follow updated program procedures relative to approval authority for disaster program applications submitted by FSA and county level employees.

FSA Response

FSA issued Notice DAP-234 to State and county FSA offices reminding them of the applicable procedures relative to approval authority for the 2003/2004 Livestock Assistance Program currently being administered.

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Exhibit C – Agency Responses

Exhibit C – Page 4 of 5

Philip Sharp
Page 2

Recommendation 8

Establish consistent application approval procedures for disaster programs, based on the next higher level of approval authority for applications submitted by FSA and county level employees.

FSA Response

FSA agrees there should be one uniform application approval procedure for disaster applications submitted by FSA and county level employees. FSA will develop a uniform application approval process based on the next higher level of authority for disaster applications submitted by FSA and county level employees.

Recommendation 9

Revise program procedures to include a clear explanation of the methodology to be followed for manually selecting random samples of program applications for spot check, including a discussion on how to expand the sample selection process when spot checks must be initiated prior to the end of program sign up.

FSA Response

The 2002 Livestock Compensation Program (LCP), on which the findings and recommendation are based, is no longer an active program. There is currently no LCP being administered.

FSA is hopeful that as more programs are transitioned to a web-based format, the selection of program applications for spot check will be an automated process that can be triggered at the applicable time to ensure a true random sample of all applicable applications is selected. However, FSA will review current disaster program procedures relating to the spot-check selection process, and ensure such procedures provide a clear explanation of the methodology to be followed. FSA will also ensure the applicable procedures provide clear instructions relating to when and how the sample selection of applications should be expanded.

Exhibit C – Agency Responses

Exhibit C – Page 5 of 5

Philip Sharp
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Recommendation 10

Clarify program procedures to specify whether applications submitted by FSA and CO employees are subject to the random sample selection process or constitute required spot checks to be completed in addition to the random sample selection process.

FSA Response

The 2002 LCP, on which the findings and recommendation are based, is no longer an active program. There is currently no LCP being administered.

However, FSA will review current disaster program procedures relating to the spot-check selection process, and ensure such procedures provide clear instructions relating to whether applications submitted by FSA and county office employees are subject to the random sample selection process or constitute required spot checks to be completed in addition to the random sample selection process.

Informational copies of this report have been distributed to:

Administrator, FSA	
ATTN: Agency Liaison Officer	(6)
Government Accountability Office	(1)
Office of Management and Budget	(1)
Director, Planning and Accountability Division, OCFO	(1)